Financial inclusion and poverty reduction: the role of financial inclusion in achieving the Millennium Development Goals.

1. It is indeed a source of deep concern that the number of people living in extreme poverty and hunger surpasses 1 billion and the inequalities between and within countries remain a significant challenge. However, we are convinced that the Millennium Development Goals can be achieved, including in the poorest countries. It will require focused efforts carried out in partnerships with all stake holders – including the private sector and through effective national strategies that work.

2. UNDP over the past year produced two reports in partnership with ESCAP and ADB, viz., Achieving the MDGs in an Era of Global Uncertainty and Paths to *2015*. The latter report was produced to coincide with the United Nations High-level Plenary Meeting on the MDGs in September 2010 in New York.

3. The reports highlight the assessment of where we are w.r.t fulfilling the MDGs in 2015 in the Asia-Pacific Region and what needs to be done to meet the targets. The Region being home to more than 60 per cent of humanity, what happens in Asia-Pacific will have a critical bearing on global MDG achievement.

4. It came out clearly that while Asia and the Pacific has much to be proud of, the countries in the Region need to redouble efforts to reduce poverty and vulnerability affecting hundreds of millions of people living in the region.

5. In identifying opportunities for action for the countries of Asia and the Pacific to achieve inclusive and sustainable development and better protect their people from this and future crises, two of the seven drivers identified for achieving the MDGs, viz., (i)

ensuring financial inclusion and (ii) strengthening social protection are particularly relevant to the Colloquium and this session.

6. Financial inclusion is critical to achieve inclusive growth and it is a prerequisite for sustainable economic growth and development. Harnessing the power of technology is one of the most effective ways of integrating the unbanked population into the financial mainstream and I understand there is a separate session on this topic. Technology enables the provision of a host of services from depositing money into various government schemes to micro loans and micro insurance. Uneven and inequitable growth has resulted in the exclusion of 51 percent of India's population (560 million people) from formal sources of finance services, which is identified as a key cause of poverty, together with illiteracy.

7. Sometime ago (2008) a Forbes article reported that an estimated 750 million households worldwide don't have a bank account. In Mexico, cash transactions constitute 79% of payments. In India 91%. In China, 82%. Even in the U.S., 80 m people are in the category of the under-banked. Most people around the world, however, own a mobile phone.

8. An ADB's study found that rural financial markets in Asia are ill prepared for the 21st century. It is mostly low-income and rural individuals and micro- and small-sector enterprises that are under-serviced by the financial industry. And without transactional banking services, their financing is insecure and expensive and the disadvantaged people cannot participate fully in the economy either as consumers or potential entrepreneurs. The unmet demand for micro-finance services is estimated to be nearly US$300 billion, of which the existing micro-finance institutions (MFIs) supply only about US$15–25 billion.

9. Lacking insurance or safety net mechanisms, the poor people cannot protect their meager assets and incomes against shocks such as illnesses or natural or man-made disasters. A comprehensive social protection program will help minimize the risks and vulnerability from economic crises and natural calamities, act as a 'circuit breaker' for vicious inter-generational cycles of poverty and hunger. It will reduce widening disparities between the rich and poor and help countries in achieving the MDGs.

10. These two drivers are related in that they steer the ability of poor households to generate income and cash flows, and increase resilience. Inclusive finance, that for me includes safety net mechanisms, enables the poor to have livelihoods, jobs and even opportunities for entrepreneurship. In 2009, world unemployment rate was estimated at 6.6%. While it varies over regions and countries, a common factor that stands out is that there has been thus far slow progress in reaching full and productive employment and ensuring sustainable livelihoods for the poor and the disadvantaged. Sustainable livelihoods are critical to reducing the proportion of people living in absolute poverty by 50% by 2015.

11. As we creatively explore innovative options to mobilize and leverage additional resources to achieve the MDGs, I would submit that we need to carefully look at the opportunities provided by remittances to enhancing access to inclusive finance and making the unbanked and under-banked bankable.

12. International migration is a fundamental feature of globalization. The benefits of migration are mostly through remittances to the country of origin and they characterize the most tangible contribution of migrants to poverty reduction. Poor economic prospects in developing countries result in part of the family living and working in an industrialized nation and sending money to support family members who remain in their home country. Migrant remittances fundamentally differ from other financial

flows in that they represent a private transaction and are mainly a family affair based on social ties and networks of responsibility and affection.

13. Over the past few decades, remittances have become increasingly prominent. Officially recorded remittance flows worldwide are estimated at around US$414 billion in 2009, with those to developing countries expected to have been around 316 billion (World Bank 2010).

14. This amount, however, reflects only transfers through official channels; and even officially recorded remittances are known to be measured with error. The balance-of-payments statistics produced by developing countries often neglect remittances received via money transfer operators and almost always exclude those transferred via informal means such as *hawala* operators, friends and family members, carried by travelers or sent by mail or money orders. These informal transfers may range anywhere from 20 per cent to 100 per cent of the official statistics on remittances and would significantly enlarge the volume of remittances if they were recorded. The true size of remittances received by developing countries is believed to be well in excess of US$ 400 billion. The latter figure when compared with the official development assistance amount of about US$120 billion in 2009 clearly reflects the changing landscape of external financing in developing countries.

15. So how does the changing financial landscape as a result of remittances affects development, both actually and potentially, of the receiving countries (also termed countries of origin). Although migration and remittances by themselves do not enable a country to escape poverty, they can stimulate equitable development. The structural problems behind the persistence of poverty have to be addressed by the national governments. However, we believe that sizeable remittance inflows in a country of

origin provide the government with opportunities to create public goods and services by leveraging private transactions. While creating efficiency in money transfers and in the use of the received amount at the household level, such a strategy can assist governments to create greater financial access and equity by catering for the unmet needs for financial goods and services of the poorer/vulnerable population.

16. There is adequate empirical evidence that remittances represent a way out of poverty for a significant population. Rural areas in developing countries tend to benefit the most because much of the world's migrants are drawn from these areas. Studies by the World Bank indicate that remittances cut the poverty rate in Uganda and Bangladesh by 11 per cent and 6 per cent, respectively, and raised education levels in El Salvador and the Philippines. Despite complex economic and political circumstances in Nepal, the country's poverty headcount ratio declined by 11% points between 1995 and 2004, with one-third to one-half of this poverty reduction being attributed to remittances.

17. Similarly there is evidence from Mexico and Egypt re remittances accounting for nearly 20 per cent of the capital invested in micro-enterprises in urban Mexico and setting up of a number of enterprises in greater Cairo, using funds brought back from abroad.

18. Generally speaking, remittances encourage consumption rather than productive investments. Nevertheless, remittances may promote development even when they are spent on consumer goods. Evidence from Mexico shows that a dollar of remittance generates three dollars of spending power. And, remittance-receiving households, when faced with favorable exchange rates, increase their investment-related activities in such things as children's education, self-employment and launching capital-intensive entrepreneurial activities.

19. The propensity to save out of remittances has been consistently found to be nearly 40 per cent across studies. In West Africa, in most savings-based MFIs such as credit unions, village banks or savings and credit cooperatives, nearly six times as many people make deposits as take out loans at any one time. Despite the prevalent recognition that the poor have a high propensity to save and that there is a considerable demand for savings instruments as a result of increased remittances, even in Latin America fewer than 10 per cent of remittance recipients are estimated to have access to savings accounts, loans or other financial services. Access to commercial banks by low-income and rural populations is limited in terms of physical distance to the closest branch of the bank, thresholds in account fees or minimum required balances, and a lack of assets and collateral opportunities for entrepreneurs.

20. What do we have to do to leverage remittances to make financial services inclusive? That poor people are bankable and creditworthy is an important lesson learned after nearly three decades of micro-credit activities. Despite the progress of micro-credit initiatives, real involvement by the world's largest financial institutions in this market or in leveraging their successes is anecdotal. There are currently examples of large private sector banks entering into risk-sharing partnerships with non-governmental or state-run MFIs that merge social mobilization skills and a rural presence with the capital resources and financial credibility of a bank.

21. Remittances provide a seamless opportunity to leverage such partnerships. The larger banks diversify their market opportunity by venturing into micro-finance at lower transaction costs by partnering with MFIs that know their customers very well. Simultaneously, the existence of larger numbers of recipient households provides profitable prospects for MFIs, which can diversify their product platform by leveraging the expertise of larger institutions into tailored products to meet the needs of their clients.

22. Along with the enhanced availability of savings and credit options, equally important are the terms on which these services are available and whether they are within the reach of the clients and entrepreneurs. With remittance-led increases in income levels, households have demand for services that allow them to manage their livelihood risks better – through, *inter alia*, access to micro-insurance products – while reducing their vulnerabilities to external shocks and stresses.

23. Additionally, MFIs would also have an opportunity to meet emerging demands for taking micro-enterprises to a bigger scale, particularly by using evidence of remittances available to finance such ventures. This would strengthen the niche of MFIs, since a good number of small and medium-sized enterprises (SMEs) need small loans, which banks, in general, are either unable or unwilling to provide because the transaction costs are relatively higher and result in lower profits per loan.

24. Even though savings products, home financing, insurance and small business loans are identified as financial services that generate these benefits and have been offered alongside remittances to either remitters or recipients, the practice has been limited. There are barriers to entry in this market segment that represent significant challenges for the private sector including (i) unfamiliarity with the products required by the poorer segment of the population (ii) inadequate expertise to interact with this new client base, (iii) an inability to leverage new technologies for the provision of financial goods and services, and (iv) emerging regulations in the money transfer market.

25. Increasingly, MFIs are participating in the remittance market through their branch network as remittance payment points for money transfer operators. Because the recipients are part of their core target consumer segment, this provides an opportunity for MFIs to cross-sell other services in addition to generating additional income through fees and foreign exchange. The lower cost structure of the MFIs' branch operations and

their presence in areas where banks do not offer services, combined with their focus and interest in creating products for low-income consumers, creates a viable business case that is not easy for commercial banks to replicate.

26. However, MFIs levy relatively high interest rates – annual percentage rates (APRs) of 25–70 per cent – because of the higher overheads required for servicing unsecured small loans to people on the margins of society and occasionally in remote locations. The sometimes lower cost of capital available to MFIs running as a double bottom line business through subsidized loans from private, government and multilateral lenders brings greater sustainability to the micro-finance business model. The micro-finance market arena is an amalgam of commercial enterprises vying with social enterprises. Even though greater competition and scale should reduce the costs of micro-finance services, many MFIs have not translated their efficiency and profitability into lowering the costs of servicing loans. The role of Compartamos Banco in Mexico and more recently SKS in India in evolving their for-profit businesses aroused great controversy partly because of very high interest rates. As we link remittances to the provision of inclusive financial services, the issue of transparency and disclosure around the rates is vital, particularly as MFIs are empowered to provide a broad range of financial services, including through linkage to remittances, rather than only small loans.

27. With the still very limited involvement of MFIs and banks offering services to remitters and recipients, money transfer currently is mainly a single-service offering that is processed separately from mainstream financial services, even if provided by financial institutions that have other products. Even though micro-finance and micro-insurance have integral links, the “mantra” that the poor are uninsurable still persists. There are opportunities that successfully demonstrate business models to connect these services and the combination of micro-finance with remittances can create viable possibilities to meet the unmet needs of the poor for of microinsurance while also increasing development benefits.

28. Given that micro-finance represents an entire range of financial products from credit, savings and insurance to payment and transfer services for the underprivileged population, the role of community-based financial institutions such as rural banks, thrift banks, cooperatives, postal savings banks and MFIs in linking remittances to development is critical. Although these institutions reach millions of financially under-served people and have self-regulatory mechanisms, they are not fully integrated in the financial system. Mainstream private banks could play a vital role to enhance access to the benefits of inclusive financial services by the poor.

29. In conclusion, given that the remittances – particularly by migrants with low skills – improve the welfare and quality of life of their recipient households, it is clear that this impact can be further reinforced. It requires generating livelihood opportunities by improving access to financial services, alleviating risks and vulnerabilities, and enhancing financial literacy among the remitters as well as the recipients. The emphasis on livelihoods is vital. Just increasing access to financial services is not a solution to poverty alleviation. It must go together with ensuring that the recipient households have the capabilities to exercise their options to access the services they need to build assets.

30. The national governments have an important role to play in facilitating/encouraging financial institutions to offer remittance-based financial products that are affordable and cater to the unmet demand of the unbanked people. While, banks on the receiving side are playing a significant role in money transfer, they have to be incentivized to expand the range of offer other financial services to the underprivileged. On the originating end of remittances, currently, banks play an insignificant role and are having minimal impact on increasing access to banking services by the unbanked; this too can be diversified through creative financial practices to assist the poor including the use of accounts receivables.

31. In fact, working with the Governments in defining comprehensive social protection programs could be the first step – an important step - in facilitating the participation of the poorest of the poor in the microfinance market making it further inclusive. Targeted and gender responsive approaches to offering minimum social floors to address extreme poverty and income security can significantly contribute to achieving MDGs including by creating sustainable livelihoods. For instance Bolsa Familia conditional cash transfer program of Brazil resulted in reducing the poverty rate from 42.7% to 28.8% in 5 years of its starting in 2003. The National Rural Employment Guarantee Act (NREGA) introduced the system of payments to the workers through accounts opened in the Banks or the Post Offices resulted in opening of 2.5 million accounts for the workers just in Karnataka State.

32. The role of the private sector as an important change agent has to be complemented by effective government policies. These are necessary to create an enabling environment for attracting investments, ensuring competition, augmenting equity, inclusiveness and social protection, use of new technologies and facilitating new markets. Public–private partnerships can widen the consumer base and create and enhance access to basic goods and services through appropriate delivery mechanisms and a transparent, accountable, participative and competitive environment.

33. Simultaneously there is a need to develop capacities at the human, institutional and system-wide levels to implement and enforce policies effectively for inclusive markets. Capacity development efforts have to be directed at (i) offsetting the risk of new products for the commercial sector, (ii) creating greater access to unreached consumers, (iii) introducing new technology, (iv) enhancing consumers' financial and technical education , (v) bringing in private sector entrepreneurial skills to improve the financial infrastructure, and (vi) setting service and credit standards.

34. Multilateral and bilateral organizations in partnership with the private sector, Diaspora and other stakeholders can assist in creating toolkits and knowledge management systems to maximize the development benefits of remittances by linking them to money transfers, savings and credit, micro-insurance and micro-pension schemes. By removing the barriers to link remittances to financial services – namely, a lack of trust in banking, financial illiteracy, and a lack of access to money transfer services – such partnerships can create opportunities for productive investment by migrants, recipients or local entrepreneurs. Although transnational social analysis can bring the micro, meso and macro perspectives together, greater learning-by-doing research is required to better understand the multiple layers of this apparently simple but intricate relationship.